



State of Hawaii
Employees' Retirement System

Information for Prospective Retirees

Hybrid Plan

October 2006

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This handout offers general information on pre-retirement issues to help you prepare for your retirement. It is not intended to cover all details. You are encouraged to attend a Pre-Retirement Session coordinated by your Personnel Office or to schedule a counseling session at the nearest ERS office when you are ready to file an application to retire.

ELIGIBILITY REQUIREMENTS AND BENEFITS

Service Retirement

Service Retirement – Full or Service Retirement – Vested/Deferred

- Age 62 with at least 5 years of credited service or
- Age 55 with at least 30 years of credited service
- 25 years of credited service as a Sewer Worker or Water Safety Officer regardless of age provided that the last five years prior to retirement is credited in such capacity.
- Graduated retirement regardless of age for Emergency Medical Technicians (Act 199/03) with the following years of credited service (and the last 5) in that capacity:

<u>Years of Service</u>	<u>Retirement Dates</u>
27	8/1/2006 to 6/1/2007
26	7/1/2007 to 6/1/2008
25	7/1/2008 to 6/1/2009

- Maximum Allowance payable:
 - $2\% \times \text{Years of Credited Service} \times \text{Average Final Compensation}$ (for Hybrid service) plus,
 - $1.25\% \times \text{years of Credited Service} \times \text{Average Final Compensation}$ (for Noncontributory service)

Service Retirement - Early

- Age 55 with at least 20 years of credited service
- 5% age reduction penalty for each year between age 55 and age 62

Note: Unused sick leave cannot be used to meet any service credit eligibility requirements

Disability Retirement

A person appointed by the Family Court as guardian of an incapacitated employee may file a retirement application on behalf of a disabled employee.

Ordinary Disability Retirement

- 10 or more years of credited service
- No minimum age
- Unable to work due to illness or injury (unrelated to work)
- Employment must not be terminated at time application is filed. Employees on “leave without pay” are eligible to apply.
- ERS Medical Board certifies permanent incapacity for the further performance of duty
- Maximum Allowance payable:
 - $2\% \times \text{Years of Credited Service} \times \text{Average Final Compensation}$ (for Hybrid service), plus
 - $1.25\% \times \text{Years of Credited Service} \times \text{Average Final Compensation}$ (for Noncontributory service)
- Minimum benefit = 25% of AFC

Service-Connected Disability Retirement

- No minimum service
- No minimum age
- Permanently disabled due to an accident on the job (which was not due to willful negligence)
- Application must be filed within two years of the accident or the date workers' compensation benefits stop
- ERS Medical Board certifies permanent incapacity for the further performance of duty
- Maximum Allowance payable: $35\% \times \text{Average Final Compensation}$, plus return of member's contributions

Note: Unused sick leave cannot be used to meet any service credit eligibility requirements.

EMPLOYEES' RETIREMENT SYSTEM CHECKLIST

15 months or more

- Attend a pre-retirement session
- Contact your own Department of Personnel Office for Schedule
- An ERS representative will discuss the retirement application process, option selections, and answer any questions

12 months

- Request a Retirement Estimate (ERS generated estimates cannot be provided earlier than 12 months in advance of your retirement date)
- Contact the ERS office on Oahu, Hawaii, Kauai or Maui
- Information needed:

<ul style="list-style-type: none"> ▪ Name ▪ Social Security number ▪ Address ▪ Birth date 	<ul style="list-style-type: none"> ▪ Retirement date (definite or tentative) ▪ Monthly gross salary ▪ Beneficiary name and birth date ▪ Any previous service, military, or maternity leaves to be acquired
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7 months

- Request a Retirement Packet
- Contact the ERS office on Oahu, Hawaii, Kauai or Maui
- The packet will include retirement forms and instructions for completing them

6 months

- Schedule a counseling appointment with a Retirement Claims Examiner (RCE)
- Contact the ERS office nearest you
- Bring your retirement packet and your spouse (recommended). During the appointment, a Retirement Claims Examiner will help you complete your retirement application; answer any questions or concerns regarding your retirement estimate; and enable you to select the best option for you and your family. Hawaii Employer-Union Trust Fund (EUTF) enrollment form, Spousal/Reciprocal Beneficiary Notification form and tax withholding form will also be completed at this time.

Not more than 150 days and not less than 30 days before retirement

NOTE: Retirement date must be the first day of the month except for December, when retirement can be on the first or the last day of the month

- File your Retirement Application
- Notarized Applications may be hand-delivered or mailed to the ERS
- Required personal documents:

<ol style="list-style-type: none"> 1) Proof of birth date for you and your beneficiary (for survivor options). (<i>Original documents only. Photocopies not accepted</i>) 2) A bank deposit slip, voided check or account number <i>for electronic deposit of pension checks</i> 	<ol style="list-style-type: none"> 3) Medicare card, if applicable, for you and your spouse required by law for <i>integration with EUTF coverage and for Medicare premium reimbursement.</i> 4) Driver's license or State ID <i>for signature validations</i>
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***Substitute any two of the following original documents with birth date or age in place of a certified birth certificate:**

- | | |
|---|--|
| <ul style="list-style-type: none"> ▪ Valid Hawaii Driver's License ▪ Hawaii State Identification Card ▪ Passport (U.S. or foreign) ▪ Marriage Certificate ▪ Naturalization Record ▪ Voter Registration Record ▪ Original Baptismal Certificate/Religious record recorded after age 5 | <ul style="list-style-type: none"> ▪ Military Record ▪ Hospital Treatment Records ▪ Life Insurance Policy ▪ School Record (with age) ▪ Child's birth certificate (with member's age) ▪ Census Record |
|---|--|

FILING YOUR APPLICATION FOR RETIREMENT

A member can file only three service retirement applications. The first two service retirement applications may be cancelled prior to their effective date; however, retirement is mandatory on the third application.

You must also notify your department to determine your 'close of business' (COB) date as well as your retirement date. Your last day on the payroll is your COB date. Your retirement date must be the 1st of the month except December, which can be the 1st or the 31st. Your COB date and retirement date cannot be the same.

Retirement applications must be notarized. Notary services are provided at all ERS locations at no charge.

ERS must provide written notification of a member's retirement date, option selection, and beneficiary designation to the member's spouse/reciprocal beneficiary.

PENSION CHECK INFORMATION

Make plans to cover expenses for your first four weeks of retirement. Your first pension check will be retroactive to your retirement date and will be mailed to your home 4 weeks after you retire. Your pension amount is based on the option you selected according to the latest estimate provided to you by the ERS. **You must sign up for the direct deposit of your pension check to an account at a financial institution.**

Payment

Your first pension check is issued approximately **4 weeks** after your retirement date pending verification of your 'close of business' date (last day on the payroll) with your personnel office. You will receive a monthly pension, which will be paid at the end of the month.

Final Pension Adjustment

Your estimated pension will be finalized following the receipt and review of your payroll/personnel records, department's audited report of any unused sick leave credits and the amount of your vacation pay. Your pension will be adjusted to an exact amount retroactive to your retirement date.

Effective January 1, 2004, ERS is required to pay 4-½% interest per annum on pensions not finalized within 6 months after the retirement date.

Taxation of Benefits

Pension benefits are subject to **Federal taxes** only.

Mailing Address Change

Mailing address changes must be reported in writing to ensure correct mailing of any correspondence, tax form, and other information.

Financial Institution Change

Financial institution changes must also be requested in writing. Change forms are available at all ERS offices or on the ERS website. Please be advised that two pension checks will be mailed to your home before any changes to the financial institution becomes effective.

RETIREMENT PLAN OPTIONS

One of the most important decisions you will make as you plan to retire is to select your retirement option. Option choices are designed to meet a range of retirement needs and goals. Pension payments continue for the retiree's lifetime for all options. However, **a beneficiary will continue to receive a lifetime pension** in the event of the retiree's death **only under Options 2, 3, Four (Five & 2), and Four (Five & 3)**. It is recommended that you consider your retirement lifestyle, projected expenses, beneficiary concerns and needs to make the best decision for you.

OPTION COMPARISON SUMMARY					
Option	Lifetime Pension to Retiree	Lifetime Pension to Beneficiary	"Pop Up" Feature	Refund of Contributions	Refund Amount
Maximum Allowance	Yes	No	No	No	None
Option One	Yes	No	No	No	None
Option Two	Yes	Yes (100%)	Yes	No	None
Option Three	Yes	Yes (50%)	Yes	No	None
Option Four (Five & Max)	Yes	No	No	Yes	Pre-1987 or 50%
Option Four (Five & 1)	Yes	No	No	Yes	Pre-1987 or 50%
Option Four (Five & 2)	Yes	Yes (100%)	Yes	Yes	Pre-1987 or 50%
Option Four (Five & 3)	Yes	Yes (50%)	Yes	Yes	Pre-1987 or 50%
Option Five	Yes	No	No	Yes	100%

Notes:

- Changes in retirement option selections are permissible prior to the effective date of retirement; however, the law prohibits any changes thereafter.
- In the event a member dies after filing a retirement application but before the member's retirement date, or if death occurs within one year of retirement, the designated beneficiary may elect to receive the survivor benefit for the option selected by the member, or the ordinary death benefit (lump sum payment or Option Two survivor benefit).
- For Options 2* and 3 or combinations with Options 4 (Five & 2)* or 4 (Five & 3), should a beneficiary predecease the retiree, the retiree's pension will be converted to the corresponding Maximum Allowance (**pop-up** feature), instead of remaining at the reduced amount and another beneficiary cannot be named.
- Pensions are increased by 2.5% on the original amount each year on July 1, following the calendar year of retirement.

Retirement Estimates

Members may use the retirement calculator available on the ERS website, which can be found at <http://www4.hawaii.gov/ers> (select Benefits Calculators from the left menu bar). The calculator will provide a reasonably accurate estimate of retirement benefits under all options. Manual worksheets and factor tables are also available from the ERS to compute a retirement benefit calculation.

* **IMPORTANT NOTICE:** Rule changes affecting 100% joint & survivor retirement options with non-spouse beneficiary.

ESTIMATE SAMPLE

RETIREMENT DATE		
BIRTH DATE		MEMBER'S AGE: 58
MEMBERSHIP DATE		
BENEFICIARY		AGE: 57
BENEFICIARY BIRTH DATE		
EARNED SERVICE (<i>Noncontributory</i>)	27 YRS	6 MOS
EARNED SERVICE (<i>Hybrid</i>)	1 YRS	6 MOS
ACQUIRED SERVICE (<i>Noncontributory</i>)	2 YRS	0 MOS
UNUSED SICK LEAVE	YRS	MOS
TOTAL MEMBERSHIP SERVICE	31 YRS	0 MOS
TOTAL COMPUTED SERVICE	30 YRS	0 MOS
*AFC = \$3,000.00/month		
** Sick Leave is NOT used in estimate computation. It is included when you actually retire and your estimated pension is finalized		

RETIREMENT OPTION	RETIREE'S MONTHLY PENSION	BENEFICIARY'S CONTINUING PENSION	POP UP TO RETIREE	INSURANCE RESERVE	REFUND AMOUNT	REFUND %
Maximum Allowance	\$1,158.00	---	---	---	---	---
One	\$1,127.00	---	---	\$181,430.00	---	---
Two (100% Survivor)	\$1,020.00	\$1,020.00	\$1,158	---	---	---
Three (50% Survivor)	\$1,085.00	\$ 542.00	\$1,158	---	---	---
Four (5 & Max)	\$1,158.00	---	---	---	---	Pre '87
Four (5 & Max)	\$1,148.00	---	---	---	\$1,620.00	50%
Four (5 & 1)	\$1,127.00	---	---	\$181,430.00	---	Pre '87
Four (5 & 1)	\$1,117.00	---	---	\$179,810.00	\$1,620.00	50%
Four (5 & 2)	\$1,020.00	\$1,020.00	\$1,158	---	---	Pre '87
Four (5 & 2)	\$1,011.00	\$1,011.00	\$1,148	---	\$1,620.00	50%
Four (5 & 3)	\$1,085.00	\$ 542.00	\$1,158	---	---	Pre '87
Four (5 & 3)	\$1,076.00	\$ 538.00	\$1,148	---	\$1,620.00	50%
Five	\$1,138.00	---	---	---	\$3,240.00	100%

SUMMARY OF OPTIONS

Options With No Refund

The following options offer a higher monthly pension because member's contributions are not refunded.

Maximum Allowance - Highest lifetime monthly pension with no refund

- No lifetime survivor benefit
- Trust, Estate, or multiple beneficiaries possible with changes allowed after retirement
- In the event of the retiree's death, beneficiary will be paid the difference between the retiree's unrefunded contributions at retirement and the retirement allowance paid prior to death

Option One - Reduced lifetime monthly pension with no refund (short-term insurance)

- Short-term (not lifetime) insurance (coverage depletes after approximately ten years)
- Large benefit if death occurs shortly after retirement
- Trust, Estate, or multiple beneficiaries possible with changes allowed after retirement
- In the event of the retiree's death, beneficiary will be paid the difference between the initial insurance reserve and the retirement allowance paid prior to death

Option Two* - Reduced lifetime monthly pension for retiree with no refund and 100% continuing pension for beneficiary in the event of retiree's death

- Beneficiary cannot be changed after retirement
- If the beneficiary predeceases the retiree, the retiree's pension "pops up" to the Maximum Allowance

Option Three – Reduced lifetime monthly pension for retiree with no refund and 50% continuing pension for beneficiary in the event of retiree's death

- Beneficiary cannot be changed after retirement
- If the beneficiary predeceases the retiree, the retiree's pension "pops up" to the Maximum Allowance

Refund Options

Members with at least 10 years of credited service qualify for any one of the following refunds:

- Nontaxable pre-1987 contributions
- 50% of contributions
- 100% of contributions (Option Five only)

Option Four (5 & Maximum) - Highest lifetime monthly pension with partial refund

- No lifetime survivor benefit (see Maximum Allowance)

Option Four (5 & 1) – Reduced lifetime monthly pension with partial refund

- Short term insurance reserve (see Option One)

Option Four (5 & 2)* - Reduced lifetime monthly pension for retiree with partial refund and 100% continuing pension for beneficiary in the event of retiree's death

- Beneficiary cannot be changed after retirement
- If the beneficiary predeceases the retiree, the retiree's pension "pops up" to the corresponding Option Four (5 & Maximum) based on the amount of the retiree's refund

Option Four (5 & 3) - Reduced lifetime monthly pension for retiree with partial refund and 50% continuing pension for beneficiary in the event of retiree's death

- Beneficiary cannot be changed after retirement
- If the beneficiary predeceases the retiree, the retiree's pension "pops up" to the corresponding Option Four (5 & Maximum) based on the amount of the retiree's refund

Option Five - Lowest lifetime monthly pension for retiree with maximum refund of contributions

- No lifetime survivor benefit
- 100% refund of contributions (and interest) with possible tax consequences
- Multiple beneficiaries with changes allowed after retirement

* **IMPORTANT NOTICE:** Rule changes affecting 100% joint & survivor retirement options with non-spouse beneficiary.

ADDITIONAL SERVICE CREDIT

Members may apply for additional service credit in the following categories prior to retirement. You must file a claim with the ERS before you retire.

Note: ERS is now able to accept monies from deferred compensation plans or tax-sheltered annuity plans to purchase allowable service credits. Please be advised that each tax-sheltered institution will need sufficient time to transfer funds to the ERS. All purchases must be completed prior to your retirement date.

Military Service

Any member who rendered honorable active military service in the armed forces of the United States can acquire up to 4 years of membership service for the military service effective July 1, 1989. Any member with:

- 8 years of credited service with the Employees' Retirement System (ERS) can acquire up to 2 years of military service if hired before June 18, 1996. (Act 136/97)
- 10 years of credited service with the ERS can acquire up to 2 years of military service if hired after June 17, 1996.
- 20 years of credited service with the ERS can acquire up to 3 years of military service.
- 25 years of credited service with the ERS can acquire up to 4 years of military service.

Military service in the reserve or National Guard is *not* considered active military service unless the service occurred in time of war or declared national or state emergency.

A member's military service is considered service in the member's occupation and percentage of full-time equivalence (FTE) at the time the service is credited and provides a corresponding retirement benefit.

If a member is eligible to acquire military service after June 30, 2006, the lump sum payment amount is based on the number of months being acquired multiplied by 6% of the member's current monthly salary. If a member was eligible to acquire military service before July 1, 2006, service can be acquired under the provisions of the plan the member was enrolled in on June 30, 2006.

Detailed information in the Military Service Credit booklet is available upon request.

Previously Refunded Contributory Service

Previously refunded State or County service as a member of the Contributory Plan, which was forfeited after termination, will be acquired on a monthly basis at no cost. Service in this capacity is credited at 1.25% in calculating your retirement benefit.

Forfeited Noncontributory Service

Previous non-vested Noncontributory Plan service which was forfeited after termination will be acquired on a monthly basis at no cost. Service in this capacity is credited at 1.25% in calculating your retirement benefit.

Previously Refunded Hybrid Service

Previously refunded Hybrid Plan service which was forfeited after termination cannot be acquired for retirement credit.

UNUSED SICK LEAVE

An employee who retires in good standing with a minimum of 60 or more days of unused sick leave shall be entitled to additional service credit.

Sixty days of unused sick leave would increase the employee's years of service by 3 months; each additional 20 days would provide 1 more month of service credit as would any balance of 10 or more days. Any remaining balance of less than 10 days would provide no further service credit.

Examples:

(1) 70 days of unused sick leave meets the requirement of 60 days minimum

<u>70 days</u>	
20 days (1 month)	= 3 months (60 days)
Balance of 10 days	= <u>1 month</u>
Total	= 4 months

(2) 85 days of unused sick leave meets the requirement of 60 days minimum

<u>85 days</u>	
20 days (1 month)	= 4 months (80 days)
Balance of 5 days	= <u>0</u>
Total	= 4 months

If sick leave is reported in hours, determine the number of unused days by dividing the total hours by 8 hours, and then calculate additional service credit as shown in the above examples.

Sick leave credit for a member with Noncontributory Plan service will be calculated on a split formula if all the sick leave could not have been earned while in the Hybrid Plan.

Upon retirement, please notify your department that the audited unused sick and vacation leave form will be needed to finalize your pension.

ORDINARY DEATH BENEFIT

The lump sum ordinary death benefit consists of the hypothetical balance of 150% of the member's accumulated contributions and interest. Ordinary death benefits are payable even if death occurred while on authorized leave without pay.

EXAMPLE: IN SERVICE AT TIME OF DEATH

BENEFIT PAYABLE

ACCUMULATED CONTRIBUTIONS AND INTEREST	\$ 40,000
ADDITIONAL 50%	+ <u>20,000</u>
LUMP SUM ORDINARY DEATH BENEFIT TOTAL	\$ 60,000

In lieu of the lump sum ordinary death benefit, the beneficiary may elect an Option Two benefit if the member was eligible for full or early retirement. If the member had 10 or more years of credited service but was ineligible for full or early retirement, the beneficiary may elect an Option Three benefit. Payments will start on the first day of the month following the date of death.

Options Two or Three are only available if one beneficiary was designated. If the member designated multiple beneficiaries or a trust, only the ordinary lump sum death benefit will be payable. If Options Two or Three are selected, the surviving spouse and dependent children may be eligible for health benefits. Please contact the EUTF at 586-7390 or HSTA/MBC VEBA Trust at 591-2823 for more information.

It is very important that the member's beneficiary designation on the Employees' Retirement System's Form 1A (Designation of Beneficiary) be in order. By law, the designation becomes null and void whenever the member's marital status changes or the designated beneficiary dies. If the beneficiary designation is not updated when either of these situations occurs, a recent amendment to the law enables the surviving spouse, reciprocal beneficiary, or dependent children to receive benefits. The surviving spouse or reciprocal beneficiary can elect Option Two if the member was eligible for full or early retirement, Option Three if the member had 10 or more years of credited service but was ineligible for full or early retirement, or a lump sum ordinary death benefit. If there is no surviving spouse or reciprocal beneficiary, dependent children under age 18 can receive the lump sum ordinary death benefit without going through probate.

TAXATION ON BENEFITS

OVERVIEW

Federal income tax:

Retirement benefits generally consist of a taxable portion and a nontaxable portion. Depending on which retirement option is selected, members must recover their after tax contributions to the ERS over their expected lifetime. The taxable and nontaxable amounts are calculated by ERS each year and reported to you and the Internal Revenue Service (IRS) on Form 1099-R issued by ERS each January.

Hawaii income tax:

Since State income tax was based on gross salary which included contributions to the ERS, retirement benefits paid are non-taxable

Other states income tax:

Since tax treatment of retirement benefits varies in different areas, please contact the state and local tax authorities for taxation requirements if you will be living outside of Hawaii.

TEN PERCENT ADDITIONAL TAX RULES (Refunds and refund options only)

If you terminate or retire and take an Option 4 or 5 refund, before age 55, an additional 10% federal income tax is assessed on the taxable portion of your Option Four/Five refund payments that is not rolled over to another qualified retirement account (such as an IRA). This 10% additional tax only applies to the taxable portion of any Option Four/Five refund payment and not the total refund payment.

The 10% additional tax, however, is not imposed on:

1. Monthly pensions.
2. Payments made to members who separate from service after age 55 and elect to withdraw their contributions.
3. Payments for disability retirement.
4. Death benefit payments to a beneficiary or member's estate.

TAX HIGHLIGHTS

1. As an active employee, deferment of federal income tax on retirement contributions.

<u>EXAMPLE</u>	
Gross Monthly Salary	\$2,000
Less Retirement Contributions (7.8%)	— 156
Subject to Federal Income Tax	\$1,844

- Purchases of service by payroll deduction are on a "pre-tax" basis and federal income taxes will be deferred until refunded.
- Contributions are subject to federal income tax upon retirement or upon termination of employment if a refund is received.

2. Computation of State income tax based on gross salary.
 - No deferment since retirement benefits not subject to State income tax.
3. All employee contributions made prior to January 1, 1987 that are included in the Option Four/Five refund payment are recovered tax-free in the year of payment. Contributions made by payroll deduction in 1987 and additional lump sum purchases of service made after December 31, 1986 made with after-tax contributions will be recovered tax-free over the retiree's estimated lifetime.

The following simplified example illustrates the tax treatment on an Option Five refund payment up to 1988.

	<u>TOTAL EMPLOYEE CONTRIBUTIONS</u> (excluding interest)	<u>TOTAL OPTION FIVE REFUND</u> (including interest)	<u>NON TAXABLE PORTION</u>	<u>TAXABLE PORTION</u>
Up to 1986	\$18,000	\$30,000	\$18,000	\$12,000
1987	2,000*	3,000	---	3,000
1988	3,000	4,000	---	4,000
Purchase of Service (1988 & on)	<u>1,000*</u>	<u>1,000</u>	<u>---</u>	<u>1,000</u>
	\$24,000	\$38,000	\$18,000	\$20,000

(*These amounts will be recovered tax-free on a prorated basis and will be reflected on future federal income tax returns. There is no "double taxation" of after-tax contributions to the Retirement System.)

Tax-free rollover of the taxable portion of the Option Four or Five refund payment into an IRA or another qualified plan is allowed.

If the taxable portion of the Option 4 or 5 refund is not directly rolled over at retirement by the ERS to an IRA or qualified plan, at least 20% of the taxable portion must be withheld for Federal income tax purposes. The 20% is a mandatory Federal income tax withholding. It is not a penalty or an additional tax. The actual amount of your federal income tax liability due on your retirement benefits is calculated when you file your federal income tax return.

Examples of the effect of the tax law on the Option Five refund payment follow:

Option Five Refund	\$38,000
Nontaxable Amount	<u>-18,000</u>
Taxable Amount	\$20,000

FULL ROLLOVER

Taxable (Check sent directly to financial institution):	\$20,000
Nontaxable Amount (Check to retiree):	\$18,000

PARTIAL ROLLOVER

Any taxable portion not rolled over is subject to the 20% mandatory income tax withholding.

Taxable	\$20,000
Rollover Amount	<u>- 5,000</u>
Net Taxable	\$15,000
Less taxes withheld	<u>- 3,000</u> (20% x \$15,000 taxable)
	\$12,000
Nontaxable Amount	<u>+18,000</u>
Check to retiree:	\$30,000

NO ROLLOVER

Option Five Refund:	\$38,000
Less Federal Withholding Tax	<u>- 4,000</u> (20% x \$20,000 taxable)
Check to retiree	\$34,000

If the retiree elects a partial rollover or no rollover at retirement, all or a portion of the taxable amount, received directly by the retiree, may still be rolled over into an IRA or qualified plan. The rollover must be done within 60 days after the payment is made by ERS to the retiree. Since the 20% would already have been withheld, recovery of the withholding would occur when personal income tax returns are filed.

The following illustrates the amount of income tax that may be payable if no rollover occurs. This example assumes an income tax rate of 35%. Remember that in this example that, 20% was already withheld. Therefore, only the difference would be due.

Income Tax at 35% (Maximum tax bracket) of \$20,000:	\$7,000
Retirement <u>Under</u> age 55: 10% Additional Tax on Taxable Portion	<u>+2,000</u>
TOTAL TAX	<u>\$9,000</u>

The actual amount of income tax that is payable will depend upon the retiree's age and tax bracket.

4. RECOVERY OF AFTER TAX CONTRIBUTIONS (refer to *IRS Publication 575 Pension and Annuity Income* for additional information)

The Employees' Retirement System uses the Simplified Method to determine the taxable and nontaxable portions of pension payments. This method enables retirants to recover their after-tax contributions over their estimated lifetime and is based upon their age at retirement. (Age determines the number of payments and portion of the monthly benefit that is nontaxable.)

The following table illustrates this method of recovery:

<u>SINGLE LIFE</u>	
<u>AGE</u>	<u>Number of Payment</u>
55 and under	360
56-60	310
61-65	260
66-70	210
71 and over	160

If your annuity start date is after 12/31/97 and is payable over the lives of more than one individual (continuing benefit), the total number of expected payments is based on the combined ages of the annuitants at the annuity starting date

<u>MULTIPLE LIFE</u>	
<u>COMBINED AGES</u>	<u>NUMBER OF PAYMENTS</u>
110 and under	410
111-120	360
121-130	310
131-140	260
141 or older	210

FORMULA:

$$\frac{\text{After Tax Contributions}}{\text{Number of Payments}} \times \frac{\text{Months Retired in Calendar Year}}{12} = \text{Annual Nontaxable Portion}$$

EXAMPLES:

Illustrations calculating the nontaxable portion of a 55 year old retirant's pension payments using the above formula and the After-Tax Contribution amounts from page 13* follow:

1. Option 5

Refund: \$38,000 (\$18,000 nontaxable)

$$\text{Pension: } \frac{\$2,000 + \$1,000}{360 \text{ payments}} \times 12 \text{ Months} = \$100 \text{ annual nontaxable portion}$$

Based on this example, if the retirant receives an annual pension of \$9,000, \$100 is nontaxable and the balance of \$8,900 is subject to federal income tax until the full after-tax contributions of \$3,000 are recovered. At that point, the entire annual pension of \$9,000 is taxable.

2. Maximum Allowance: Options One, Two and Three

Refund: None

$$\text{Pension: } \frac{\$18,000 + \$2,000 + \$1,000}{360 \text{ payments}} \times 12 \text{ months} = \$700 \text{ annual nontaxable portion}$$

In this example, the after-tax contributions to be recovered as part of the monthly pension payments totals \$21,000 (including nontaxable pre-1987 contributions of \$18,000) since there is no refund of contributions taken. If the retirant receives an annual pension of \$12,000 and elected the Maximum Allowance or Option One, the recovery of after-tax contributions will be over 360 months. Therefore, \$700 is nontaxable and the balance of \$11,300 is subject to federal income tax until the full after-tax contributions of \$21,000 are recovered. At that point, the entire annual pension of \$12,000 is taxable.

If the retirant selected a continuing beneficiary option (Options Two or Three), then the recovery period is based on the combined ages of the retirant and the beneficiary. Using the above example of a retirant age 55 and a continuing beneficiary age 54, with a combined ages of 109, then contributions will be recovered over a period of 410 monthly payments, resulting in \$615 nontaxable each year and \$11,385 being subject to federal income taxes.

**If the annuity is based on a continuing benefit [Options 2,3,4(2) or 4(3)], and started after 12/31/97, the number of payments would be based on the combined ages of the annuitants.*

FREQUENTLY ASKED TAX QUESTIONS

1. *Are my retirement benefits subject to State of Hawaii taxes?*

No, all benefits paid by ERS are nontaxable for State of Hawaii income tax purposes. In the event that a member moves to a different state, the ERS strongly recommends that the member confer with his or her accountant or tax consultant to determine the state and local tax treatment of any distribution

2. *If I do not select Option Four or Five, why am I being taxed on my "own" money that was already taxed when I was working?*

You are not being taxed on your own money. Under current law, you may only recover your after-tax contributions over your expected lifetime, or the expected lifetime of you and your beneficiary if a continuing beneficiary option is selected. Using tables prescribed by the Internal Revenue Service, a portion of your monthly pension is nontaxable as a recovery of your after-tax contributions. The remaining portion is considered taxable. Once your after-tax contributions are fully recovered, your entire monthly pension is taxable for federal income tax purposes.

3. a) *What happens if I should die before I recover my own contributions?*

If you selected Option Two, Three, or Four (Five & Two, Five & Three), your beneficiary will continue to recover your after-tax contributions at the same rate until the total after-tax contributions are recovered.

If there are any remaining after-tax contributions to be recovered, the "last-to-die" (either the pensioner or the continuing beneficiary) is allowed to take a deduction on their final income tax return. This deduction is treated as a net operating loss deduction from a trade or business under IRC § 172. Please see the instructions for Form 1040, Schedule A, Miscellaneous Deductions for more information.

(b) *Are my death benefits taxable to my beneficiaries or estate?*

Yes. However, in certain cases, part of the death benefits may be nontaxable if there are unrecovered after-tax contributions.

4. *Can I rollover the taxable portion of my Option Four or Five refund payment into an Individual Retirement Account (IRA)?*

Yes, the taxable portion can be rolled over into an IRA or another qualified plan. Refund payments to terminating employees who forfeit retirement benefits and death benefits paid to spouses can also be rolled over.

Members should seek the advice of a financial consultant or call the applicable qualified plans or administrator of the IRAs, to determine if the plan they are interested in is qualified.

5. *Can I rollover the taxable portion of my Option Four or Five refund payment to my tax deferred compensation or tax sheltered annuity (TSA or TDAs) plans?*

Yes, you can rollover the taxable portion of your refund payment to your tax deferred compensation or tax sheltered annuity plans. However, since subsequent distributions of the ERS rollover is not subject to State of Hawaii income taxes, except for earnings on the rollover, it is recommended that you maintain a separate account or you will need to determine what portion of the subsequent distribution is not taxable for State of Hawaii income taxes.

6. *After I retire, how will I know the taxable amount that I need to pay the IRS?*

You will receive Form 1099R by January 31 of each year with information necessary to file your federal income tax return.

7. The ERS withheld 20% from the taxable portion of my Option Four or Five refund for federal income taxes and I had withholding from my monthly pension payments based on the withholding tables. However, I still had to pay a large tax bill when I filed my income tax return for last year. Why did I have such a large balance owed for last year's tax return?

The amount that you owe for federal income taxes in any given year is based on your total income from all sources (such as wages and salaries, dividends and interest, income from self-employment, and your pension benefits). If you chose not to rollover the taxable portion of your Option Four or Five refund payment and you retired or separated from service prior to the year you reached age 55, you may also be subject to an additional 10% tax on the taxable portion not rolled over. If you received a lump-sum payment for any unused vacation credits, in addition to the refund option payment from ERS, you may also have been subject to higher tax rates than you normally pay.

The ERS calculates federal income tax withholding based on the pensioner's instructions for monthly pension payments. Pensioners have the option not to have federal income taxes withheld from their monthly pension payments. The ERS is required however to withhold 20% of the taxable amount of any refund option payments not rolled over. We recommend that you review your tax situation to determine the appropriate amount to be withheld each year and consult with your financial advisor, CPA, or tax preparer, if needed.

ERS Office Locations, Phone Numbers and Website Address

The Employees' Retirement System (ERS) headquarters is located on the corner of Merchant and Alakea Streets on the 14th floor of the City Financial Tower in downtown Honolulu. Validated parking is available in the building. Enter the City Financial Tower parking entrance on Richards Street.

Office hours are from 7:45 a.m. to 4:30 p.m. Monday through Friday (except holidays).

OFFICES:

Oahu	Employees' Retirement System City Financial Tower 201 Merchant Street, Suite 1400 Honolulu, HI 96813 Benefits Branch: 586-1735 Fax: (808) 587-5766
Hawaii	Hawaii District Office 101 Aupuni Street, Suite 208 Hilo, HI 96720 (808) 974-4077 or 974-4076 Toll-free to Oahu @ 974-4000 Ext. 61735
Kauai	Kauai District Office 3060 Eiwa Street, Room 302 Lihue, HI 96766 (808) 274-3010 or 274-3011 Toll-free to Oahu @ 274-3141, Ext. 61735
Maui	Maui District Office 54 High Street, Room 218 Wailuku, HI 96793 (808) 984-8181 or 984-8282 Toll-free to Oahu @ 984-2400, Ext. 61735
Molokai/Lanai	Toll-free to Oahu @ 1-800-468-4644, Ext. 61735
US Mainland Only	Toll-free to Oahu @ 1-888-659-0708, Ext. 61735
Website	www4.hawaii.gov/ers